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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 118

FEDERAL TRADE COMMISSION, PETITIONER

v.

BROWN SHOE COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE FEDERAL TRADE COMMISSION

OPINIONS BELOW

The opinion of the court of appeals (R. 574–591) is reported at 339 F. 2d 45. The opinion of the Federal Trade Commission (R. 48–84) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on December 8, 1964 (R. 592). On March 8, 1965, Mr. Justice White extended the time for filing a petition for a writ of certiorari to and including May 7, 1965. The petition for a writ of certiorari was filed on that date, and was granted on October 11, 1965 (R. 594; 382 U.S. 808). This Court has jurisdiction under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Pursuant to the "Franchise Stores Program" of the Brown Shoe Company, more than 700 independent

retail shoe stores agreed, in return for a number of services and benefits, to carry no line of shoes conflicting with Brown Shoe brands. The Federal Trade Commission held the "Franchise Stores Program" to be an unfair method of competition under Section 5 of the Federal Trade Commission Act, finding that the plan "effectively foreclosed * * * [Brown's] competitors from selling to a significant number of retail shoe stores." The question presented is whether the court of appeals erred in reversing the Commission's decision on the grounds that the Brown plan did not involve sales methods which have "heretofore been '* * * regarded as opposed to good morals because characterized by deception, bad faith, fraud or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or create monopoly' " (*Federal Trade Commission* v. *Gratz,* 253 U.S. 421, 427), and that the Commission had not shown the plan to be unlawful as either a tying arrangement or an exclusive dealing agreement.

STATUTES INVOLVED

Section 5(a) of the Federal Trade Commission Act, 38 Stat. 717, 719, as amended, 15 U.S.C. 45(a), provides in pertinent part:

> (a)(1) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful.
>
> *   *   *   *   *
>
> (6) The Commission is empowered and directed to prevent persons, partnerships,

> or corporations * * * from using unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce.

Section 3 of the Clayton Act, 38 Stat. 731, 15 U.S.C. 14, provides:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

STATEMENT

The court of appeals set aside an order of the Federal Trade Commission (R. 37, 46–47) prohibiting the Brown Shoe Company, Inc. ("Brown") from entering into or maintaining agreements with independent shoe retailers, or from imposing conditions upon such retailers, which have the purpose or effect of inter-

fering with retailers' independent determination whether to purchase shoes from Brown's competitors.[1] The proceeding before the Commission was instituted by a complaint (R. 1–6) issued on October 13, 1959, charging Brown with unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act. Following extensive administrative proceedings, the Commission, on February 20, 1963, issued its opinion and final order (R. 46–47, 48–84).

1. THE FACTS

Much of the relevant evidence is undisputed. The Commission found the following facts:

A. BROWN'S FRANCHISE PROGRAM

In 1959, Brown was the country's second largest manufacturer of shoes in terms of dollar volume (R. 71) and the third largest in terms of pairs of shoes produced (*ibid*). It produces leather shoes of almost every type for men, women, and children, within the range categorized broadly as "medium priced" (R. 42). In addition to marketing its shoes through mail order houses and a substantial number of company-owned retail stores, Brown distributed shoes through approximately 6,000 independent retail shoe stores (R. 17). More than 700 of these stores participate in the "Brown Franchise Stores Program" (R. 19). Under this program, Brown offers a "package" of benefits and services, including "architectural plans,

[1] The court also reversed a Commission finding that Brown Shoe attempted to fix and maintain the retail prices at which its franchisees would sell Brown products (R. 74–82). Since that determination depended upon the substantiality of evidence to establish particular facts, the Commission has not sought review thereof.

service of a field representative, merchandising records, retail sales training program, accounting system, national and regional meetings, and group purchasing of insurance, rubber footwear, and display material" (R. 60, n. 17) in return for a promise (either written or oral) that the retailer will (R. 51):

> * * * [c]oncentrate my business within the grades and price lines of shoes representing Brown Shoe Company Franchises of the Brown Division *and will have no lines conflicting with Brown Division Brands of the Brown Shoe Company.* [Emphasis added.]

The services provided under the franchise plan are valuable. For example, Brown's architectural department draws plans, at the request of a franchisee, either for designing a new store or for redesigning an old one, "complete from the ground up and from the sidewalk to the rear door" (R. 109). Over the years, approximately 50 percent of the Brown franchise accounts have used this service (R. 110).

Brown's field representatives call upon franchise dealers regularly, giving advice regarding proper methods of merchandising, record-keeping, personnel administration, advertising and sales promotions, and "other matters pertinent to a profitable shoe business" (R. 13). Field men also assist franchisees in checking inventories, "in making out a seasonal buying and sales plan," and in performing end-of-the-year inventory and audits (R. 111). Franchisees are also given the opportunity to attend regional meetings and national conventions, where dealers exchange ideas for operating their businesses "more efficiently and profitably" (R. 622).

The group insurance which is available to franchise dealers—including life, fire, public liability, burglary, and business operation insurance—is, according to Brown, substantially cheaper than that which the retailers could purchase locally (R. 116); many franchise dealers testified that they take advantage of the insurance and regard it as a valuable benefit (*e.g.,* R. 278–279, 363). Franchisees also enjoy substantial discounts on canvas and waterproof footwear manufactured by U.S. Rubber Company (R. 21).

The Commission found that this set of benefits and services provides the "prime motivation" for dealers joining and continuing to participate in the franchise program. Although not every dealer takes advantage of each benefit, the Commission found that "collectively" these benefits achieved the intended effect of attracting retailers to the program and inducing them to comply with its restrictions (R. 60–61). The franchise agreement is terminable by either party upon 30 days' notice, but the Commission found that in actual operation "the relationship between Brown and its franchisees is a reasonably stable one" (R. 63).[3]

[3] In *Brown Shoe Co.* v. *United States,* 370 U.S. 294, 338, n. 66, this Court, in discussing the same franchise program, stated: "Since the retailer was required, under this plan, to invest his own resources and develop his good will to a substantial extent in the sale of Brown products, the flow of which Brown could readily terminate, Brown was able to exercise sufficient control over these stores and departments to warrant their characterization as "Brown" outlets for the purpose of measuring the share and effect of Brown's competition at the retail level. Cf. *Standard Oil Co. of California* v. *United States,* 337 U.S. 293."

B. EFFECT OF THE RESTRICTIVE PROVISIONS

Although Brown contended before the Commission that the explicit restriction in the franchise agreement that its retailers not handle conflicting lines is ignored in practice, the Commission found that Brown in fact enforces the provision. The franchise agreements are policed by a team of field men whose report forms bore for a period of time the printed legend: "Encourage concentration on B.S.C. lines and elimination of conflicting lines" (R. 54). The record contains much documentary evidence that the field men followed their instructions and regularly discouraged the purchase, or urged the elimination, of other manufacturers' lines which conflicted with the Brown lines (R. 53–54, 691–722).[3]

[3] The Commission's opinion quoted the following excerpts from field reports and correspondence between field men and headquarters Franchise Division personnel:

"He has been urging us to allow him to carry 'Town and Country' which are profitable for him in Willimantic and has been refused. I am leaving Risque in as a cushion for this problem. Time will have to settle that problem." (R. 52–53—Brown Franchise Division Inter-Company Correspondence—McEmery to Lou Carrol, dated February 4, 1957, regarding Prague Shoe Company, New London, Conn.)

"Outside lines were discussed and she also agrees that most are not necessary and will be discontinued. This will eliminate many over-lapping patterns and types that she does not need in this low-volume store." (R. 53—Report of field man Bob Taylor to Tom Curtis regarding White's Shoe Store, Lancaster, New Hampshire, July 19, 1958.)

"I think it is time for a forthright discussion with Mr. Bump on what we attempt to accomplish with dealers who operate their business on our Franchise Program. If he does not see the wisdom of going along with the thought of operating these stores more progressively, avoid directly conflicting purchases, then I think we have no other alternative than to

Brown generally permits its franchisees to remain in the plan (and thus receive its benefits) even if they carry short or specialty lines which only partially "conflict" with its own brands (R. 27–28). If, however, a franchisee refuses to discontinue a major conflicting line, he may be dropped from the franchise plan (R. 54–55). (Non-franchise dealers can purchase shoes from Brown, but they do not receive most of the benefits offered under the plan to franchised dealers.) During the years 1949 through 1955, Brown Shoe dropped 22 stores from the franchise program for "persist[ing] in carrying conflicting lines" (R. 55) and from November 1954 to April 1958, a dozen or more dealers were similarly dropped (R. 24–25).

The Commission found that, on the whole, Brown is successful in getting its franchisees to exclude competing lines (R. 63). On the average, franchised stores purchase 75 percent of their total shoe requirements from Brown, with most of the remainder consisting of shoes of higher or lower price than those available from Brown—*i.e.,* shoes which do not constitute "conflicting" lines within the meaning of the agreement (*ibid*).

The evidence showed the effect of the Brown franchise plan in foreclosing retail outlets to Brown's competitors—particularly small manufacturers. Thus, the Leverenz Shoe Company (a firm not among the top 70 (R. 740)), sold one retailer $2,399.12 worth

ask him to withdraw from the program." (R. 53—Letter to field man T. R. Forgan from Dick Johnston, Manager of the Brown Franchise Stores Division, dated February 18, 1958, regarding Lloyd's Shoes, Wichita and Great Bend, Kansas.)

of shoes in 95 but lost the account altogether in 1957 when the retailer became a Brown franchisee (R. 65). Similarly, the Weyenberg Shoe Co. (the 46th largest manufacturer in the country in terms of output (R. 740)) saw sales to two of its accounts drop from $8,388 to $186.00 and from $2,782 to zero, respectively, when the dealers joined the Brown franchise program and agreed to drop conflicting lines (R. 65). And the Juvenile Shoe Corporation (ranked 60th in pairage output (R. 740)), which had formerly sold as many as 1,530 pairs of shoes annually to a shoe store in Plymouth, Michigan, suffered a decline to only 188 pairs following the store's enrollment in the Brown plan (R. 65). Several of Brown's competitors testified that they no longer made any serious effort to sell Brown franchised stores because they felt it would be a waste of time (R. 73).

2. THE COMMISSION'S DECISION

The Commission affirmed the examiner's findings (R. 15–30) that, as a result of Brown Shoe's franchise plan, its "competitors are foreclosed from selling to the market represented by the franchise dealers" (R. 63). The Commission found that (R. 66):

> * * * whatever a dealer's reasons may have been for entering the program, once he became a participant he was subject to the agreement or understanding requiring him to refrain from purchasing a competitor's conflicting lines and to concentrate on respondent's products. The record is plain that whatever the merit of its products, respondent added to its

> competitive arsenal the franchise plan embodying restrictions, which necessarily foreclosed competitors from effectively selling to the select group of retailers under that program.

The Commission concluded that "the franchise plan was a major factor in foreclosing markets to competitors of respondents" (R. 62) and that it therefore "constitutes an unfair trade practice under Section 5 of the Federal Trade Commission Act" (R. 68).[4]

Although the Commission rejected the argument that, in a proceeding under Section 5 of the Federal Trade Commission Act challenging a trade practice primarily on the ground that it unduly forecloses competitors, the Commission must apply the precise test applicable to requirements contracts under Section 3 of the Clayton Act, it concluded (R. 70), after a full canvass of the structure of the shoe industry, its developing trend toward concentration, and Brown's role in that trend, particularly as shown by this Court's decision in *Brown Shoe Co.* v. *United States*, 370 U.S. 294, "that the prospective competitive impact of the franchise program is such that the standards of illegality under Section 3 and Section 7 of the Clayton Act, as amended, have been met." In summary, the Commission found (R. 74) that "[t]o foster the competitive position of the smaller manufacturers,

[4] It also observed (R. 68): "* * * [t]he practice of conditioning the benefits of membership in the plan to adherence to the restrictive terms of the franchise agreement for the purpose of foreclosing other manufacturers from selling to its franchisees is akin to the operation of tying clauses generally held as inherently anticompetitive."

Brown should be prohibited from entering into arrangements with its customers interfering with the latter's independent judgment in making purchasing decisions." Commissioner Elman concurred in this decision on the ground that the "exclusive vertical arrangements shown by the record have the requisite competitive effects * * *" (R. 83–84).

3. THE COURT OF APPEALS' DECISION

The court of appeals reversed the Commission's decision and directed dismissal of the complaint. Relying on *Federal Trade Commission* v. *Gratz,* 253 U.S. 421, 427, the court ruled that the Brown franchise program "could [not] possibly be classified as an 'unfair method of competition'." Noting that Brown, International Shoe Company (the nation's leading manufacturer of shoes (R. 741)), and Genesco (the nation's third leading shoe producer (*ibid.*)) have operated such programs for a number of years, it stated that "[n]o court has gone so far as to hold like programs or methods of doing business unlawful under Section 5 of the Federal Trade Commission Act and such programs or sales methods have never heretofore been '* * * regarded as opposed to good morals because characterized by deception, bad faith, fraud, or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or create monopoly'." The court went on to hold in some detail that Brown Shoe's franchise program did not constitute an illegal tying arrangement under the Sherman Act or Section 3 of the Clayton Act. Without any elaboration or explana-

tion the court also stated that "there was a complete failure to prove an exclusive dealing agreement which might be held violative of § 5 * * *" Finally, the court found this Court's decision in *Brown Shoe Co.* v. *United States, supra,* wholly irrelevant.

SUMMARY OF ARGUMENT

The Brown Shoe Company operates a franchise plan under which independent retailers receive valuable benefits and services in exchange for their express promise not to handle shoes which compete with lines manufactured by Brown. The Federal Trade Commission found that the plan was unfair because the restrictive agreement foreclosed Brown's competitors and threatened a substantial lessening of competition in the shoe industry which, as demonstrated in *Brown Shoe Co.* v. *United States,* 370 U.S. 294, has already shown a marked trend toward concentration and vertical integration. It issued a cease and desist order against the plan. The court of appeals set the order aside under *Federal Trade Commission* v. *Gratz,* 253 U.S. 421, on the ground that plans like Brown's have not heretofore been held by the courts to be immoral or anticompetitive. It did not consider the plan's effect in foreclosing competition and it treated *Brown Shoe Co.* v. *United States, supra,* as irrelevant.

Section 5 of the Federal Trade Commission Act is a broad and flexible grant of authority to the Commission to stop in their incipiency trade practices which threaten to restrain competition. In giving content

to the proscription in Section 5 of "unfair methods of competition" the Commission is guided by the substantive provisions of the antitrust laws but it is not restricted to a mechanical application of those provisions. The narrower standard suggested by *Federal Trade Commission* v. *Gratz,* 253 U.S. 421, 427, was disapproved by this Court in *Federal Trade Commission* v. *Keppel & Bro.,* 291 U.S. 304, 309-310.

The practice involved here foreclosed to Brown's competitors a substantial number of retail outlets by what is in effect an exclusive dealing arrangement of the kind condemned under Section 3 of the Clayton Act. Whether or not Brown's arrangement falls within the precise terms of Section 3, it can properly be reached under Section 5, which covers not only recognized antitrust violations, but conduct which bears the characteristics of such violations. *Atlantic Rfg. Co.* v. *Federal Trade Commission,* 381 U.S. 357. Although the Commission found that the Brown plan clearly had such characteristics and was in effect an exclusionary arrangement condemned under the antitrust laws, the court of appeals treated the plan as an inherently lawful arrangement which could under no circumstances be reached under Section 5. In doing so, the court of appeals misconceived Section 5 and disregarded the Commission's analysis of the plan's operation and effect.

In light of the history and structure of the shoe industry, the extent of the foreclosure effected by Brown's franchise program, and the absence of any eco-

nomic justification for such foreclosure, the Commission properly found that the program met the standards of illegality of Section 3 of the Clayton Act. Brown's franchise program has preempted some 766 choice retail outlets to which Brown sold more than $24,000,000 worth of shoes in 1959. Those 766 stores constitute approximately 1 percent of the retail shoe stores in the country. However, the Commission held that, while the percentage of the market foreclosed is important, it will seldom be determinative. Reviewing the relevant economic and historical factors, which the court of appeals completely ignored, the Commission concluded, as had this Court before it in *Brown Shoe, supra,* that in light of the structure of the shoe industry which demonstrates marked trends toward concentration and vertical integration, the preemption by Brown of several hundred retail stores as its exclusive dealers tends substantially to lessen competition.

Moreover, the restrictive agreements which Brown has solicited and enforced appear to be wholly devoid of any redeeming economic justification. The services and benefits Brown offers can be furnished as well without the exaction of an exclusionary agreement which forecloses competition. The restrictive agreement is not needed to assure the retailer a source of supply, and it does not commit Brown with respect to price. Brown is not a new company which might require such an agreement to enter the market. The restrictive agreement clearly serves no purpose except to suppress competition and is thus, as the

Commission found, akin to the operation of tying clauses, which are inherently anti-competitive.

Because the franchise program clearly appears as the growing edge of a continuous drive toward the foreclosure of retail outlets by an increasingly concentrated group of manufacturers, the very result proscribed by the Court in *Brown Shoe, supra,* and because it is totally lacking in economic justification, the Commission was justified in condemning it as an unfair method of competition.

ARGUMENT

I. THE BROWN FRANCHISE PLAN INVOLVES A MARKET FORECLOSURE OF THE TYPE PROSCRIBED BY SECTION 3 OF THE CLAYTON ACT WHICH THE FEDERAL TRADE COMMISSION COULD PROPERLY REACH UNDER SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT

A. THE COURT OF APPEALS FAILED TO RECOGNIZE THE SCOPE OF THE COMMISSION'S AUTHORITY UNDER SECTION 5 TO FORESTALL PRACTICES RESULTING IN COMPETITIVE EFFECTS PROSCRIBED BY SECTION 3

Without considering the probable effect upon competition of the substantial market foreclosure resulting from the Brown Shoe franchise plan, the court of appeals held that the Commission could not condemn the plan as an unfair method of competition under Section 5 of the Federal Trade Commission Act because, under *Federal Trade Commission* v. *Gratz,* 253 U.S. 421, 427, such plans "have never heretofore been 'regarded as opposed to good morals because characterized by deception, bad faith, fraud or oppression, or as against public policy because of their dangerous tendency un-

duly to hinder competition or create monopoly' * * *'' (R. 585). The decision reflects an erroneously narrow reading of the reach of Section 5.

Section 5 is a broad and flexible provision whose implementation by the Commission depends upon the particular circumstances in which the practice questioned is employed. It reaches every trade practice which significantly restrains competition or threatens such a restraint if permitted to grow beyond its incipient stages. It was intended "to supplement and bolster the Sherman Act and the Clayton Act * * * to stop in their incipiency acts and practices which, when full blown, would violate those acts * * * as well as to condemn as 'unfair methods of competition' existing violations of them." *Federal Trade Commission* v. *Motion Picture Adv. Serv. Co.*, 344 U.S. 392, 394–395; *Federal Trade Commission* v. *Cement Institute*, 333 U.S. 683, 691; *Federal Trade Commission* v. *Keppel & Bro.*, 291 U.S. 304, 309–310.

That congressional purpose could not be achieved if the Commission could prohibit under Section 5 only those practices which earlier court decisions had condemned as immoral or anti-competitive. It was in recognition of this fact that this Court in *Keppel*, *supra*, after a careful review of the legislative history of the Act, disapproved the approach taken in *Gratz*, and other early decisions which had failed to give sufficient weight to the legislative purpose underlying the statute.[5] Thus this Court has rejected the limited

[5] See *Federal Trade Commission* v. *Beech-Nut Packing Co.*, 257 U.S. 441, 453; *Federal Trade Commission* v. *Raladam Co.*, 283 U.S. 643, 652; *Federal Trade Commission* v. *Royal Milling Co.*, 288 U.S. 212, 217.

interpretation of the reach of Section 5 which was the basis of the court of appeals decision.

In giving content to the generalized language of Section 5, the Commission has used recognized violations of the antitrust laws as a guideline. But it is not limited to "a mechanical application" of the Sherman and Clayton Acts. *Atlantic Rfg. Co.* v. *Federal Trade Commission,* 381 U.S. 357, 369-370. Section 5 reaches not only recognized antitrust violations, but also conduct which bears "the characteristics" of such violations (*ibid.*). The more constricted interpretation adopted by the court of appeals renders Section 5 largely redundant and rejects the congressional perception that "there is no limit to business ingenuity and legal gymnastics" (*id.* at 367).

The court of appeals did not disturb the Commission's findings as to the anticompetitive effect of Brown's franchise plan, and it therefore seems undeniable that the plan entailed a restrictive vertical arrangement which foreclosed to Brown's competitors a substantial number of retail outlets. Such foreclosure of outlets to competitors is the kind of restraint that Section 3 of the Clayton Act condemns (see pp. 18-21, *infra*). Since the use of Section 5 to challenge exclusive vertical arrangements which might not conform to the precise patterns outlined in Section 3 has previously been sanctioned by the Court (*Atlantic Rfg. Co.* v. *Federal Trade Commission,* 381 U.S. 357; cf., *Federal Trade Commission* v. *Motion Picture Adv. Serv. Co.,* 344 U.S. 392), the Commission was certainly free to proceed under Section 5 even if

the plan did not fall precisely within the terms of Section 3.

B. BROWN'S EXCLUSIONARY ARRANGEMENT IS THE TYPE OF AGREEMENT PROSCRIBED BY SECTION 3

The court of appeals held that "there was a complete failure to prove an exclusive dealing agreement which *might* be held violative of §5" (R. 591; emphasis added). It reached this conclusion without any discussion or explanation, and its meaning is not entirely clear. If the court meant that there was no evidence of an exclusionary agreement, it failed to understand the significance of the undertaking by each franchisee to carry "no lines conflicting with Brown Division Brands of the Brown Shoe Company" (R. 580). There is no real dispute as to the meaning of that undertaking; it obligated retailers not to purchase types and grades of shoes manufactured by Brown from manufacturers other than Brown. The Commission was certainly justified in observing (R. 51) that "[t]he proviso on its face restricts franchisees as to the purchases they may make from competitors of Brown." The Commission found that in practice the agreement resulted in the preemption by Brown of 75 percent of the requirements of its franchised dealers. It thus seems undeniable that, as to the types and grades of shoes it produced, Brown obtained exclusive dealing agreements with its retailers.

If, on the other hand, the court of appeals meant that the agreement which was proved was one which under no set of surrounding circumstances could be held unlawful, the court was plainly in error. Such

a view would naturally lead the court to find, as it apparently found, that it was completely unnecessary to consider the historical and economic factors which the Commission thought to be decisive. Indeed, the court of appeals did not reject the Commission's finding that by operation of its franchise plan Brown "has effectively foreclosed its competitors from selling to a significant number of retail shoe stores." (R. 68).

Of course, the Commission's opinion was concerned with "the impact of the particular practice on competition, not the label that it carries" (*Federal Trade Commission* v. *Motion Picture Adv. Serv. Co.*, at 397), and its analysis of the facts was primarily directed to the effect of the plan in foreclosing competition. Exclusionary arrangements fall under Section 5 of the Federal Trade Commission Act if they violate the policies of the Sherman Act (*Federal Trade Commission* v. *Motion Picture Adv. Serv. Co., supra*), or Section 3 of the Clayton Act (*Fashion Originators' Guild* v. *Federal Trade Commission*, 312 U.S. 457). Thus, in *Atlantic Rfg. Co.* v. *Federal Trade Commission, supra,* conduct having consequences proscribed by Section 3 of the Clayton Act but not precisely within the bounds of that section was nevertheless held to violate Section 5.

An exclusive dealing arrangement is a contract under which a purchaser agrees not to use or deal in the merchandise of his seller's competitors. See *Standard Fashion Co.* v. *Magrane-Houston Co.*, 258 U.S. 346; *Fashion Originators' Guild* v. *Federal Trade Commission, supra; Federal Trade Commission* v. *Motion Picture Adv. Serv. Co., supra; Standard Oil Co.*

of California v. *United States,* 337 U.S. 293; *Tampa Electric Co.* v. *Nashville Coal Co.,* 365 U.S. 320, 327. Even if the Brown plan does not fall within the literal language of Section 3, it nevertheless falls clearly within the policy of Section 3, for services are furnished to retailers only upon the condition or understanding that they will not handle the shoes of Brown's competitors.

The services and benefits furnished by Brown are not, as the court of appeals assumed (R. 591), some kind of "free" premium customarily furnished retailers. They are the consideration for an express promise to foreclose competitors, and they represent a considerable value to the retailer, who might otherwise have to pay for them—without assistance from Brown (and without foreclosure of Brown's competitors).

All this was plainly disclosed in the Commission's analysis of the restrictive aspects of the agreement and the actual foreclosure of competition resulting from its use. From its review of the evidence the Commission concluded (R. 63):

> The foregoing summary of the facts establishing that *conflicting lines of competitors are excluded by virtue of the enforcement of the terms of the restrictive proviso in the franchise agreement,* and that such enforcement of the proviso was substantially effective, is sufficient to support the examiner's finding that respondent's competitors are foreclosed from selling to the market represented by the franchise dealers. [Emphasis added.]

With respect to respondent's contention that retailers' adherence to the plan was purely voluntary, the Commission found (R. 66):

> * * * [W]hatever a dealer's reasons may have been for entering the program, once he became a participant he was subject to the agreement or understanding requiring him to refrain from purchasing a competitor's conflicting lines and to concentrate on respondent's products. The record is plain that whatever the merit of its products, respondent added to its competitive arsenal the franchise plan embodying restrictions, which necessarily foreclosed competitors from selling to the select group of retailers under that program.

Thus the Commission's conclusion that the franchise plan is an unfair method of competition under Section 5 of the Act rested squarely upon "[r]espondent's practice of conditioning the benefits of membership in the plan to adherence to the restrictive terms of the franchise agreement for the purpose of foreclosing other manufacturers from selling to its franchisees * * *" (R. 68).

II. IN LIGHT OF THE HISTORY AND STRUCTURE OF THE SHOE INDUSTRY, THE EXTENT OF THE FORECLOSURE EFFECTED BY BROWN'S FRANCHISE PROGRAM, AND THE ABSENCE OF ANY ECONOMIC JUSTIFICATION FOR SUCH FORECLOSURE, THE COMMISSION PROPERLY FOUND THAT THE PROGRAM VIOLATED THE POLICY OF SECTION 3 OF THE CLAYTON ACT

We have shown above that the agreement by Brown's franchised dealers not to carry lines "conflicting" with Brown's shoes is the type of vertical

arrangement to which Congress addressed itself in Section 3 of the Clayton Act. Whether or not the franchise program violated the standards of Section 3 in all respects, the Commission found that "the *prospective competitive impact* of the franchise program is such that the standards of illegality under Section 3 * * * have been met" (R. 70, emphasis added). The remaining question is whether that finding "has 'warrant in the record' and a reasonable basis in law." *Atlantic Rfg. Co.* v. *Federal Trade Commission,* 381 U.S. 357, 367. The record before the Commission, including the decision of this Court in *Brown Shoe Co.* v. *United States,* 370 U.S. 294, revealed (a) that the industry had experienced a history of progressive concentration and foreclosure in which Brown was a leading force, (b) that no redeeming economic justification could be shown by Brown for the restrictive agreement, and (c) that the franchise plan "was a major factor in foreclosing markets to competitors" (R. 62). We turn to an examination of these factors to demonstrate that this restrictive vertical arrangement is repugnant to the standards of the Clayton Act and may therefore be held unlawful under Section 5 of the Federal Trade Commission Act.

A. THE TREND TOWARD CONCENTRATION AND VERTICAL INTEGRATION IN THE SHOE INDUSTRY

In evaluating the Brown franchise system, the Commission was concerned with the same conditions and trends in the shoe manufacturing industry of which this Court took note in *Brown Shoe Co.* v.

United States, 370 U.S. 294. The competitive structure of the industry shows marked trends both toward concentration and toward vertical integration. The economic and legal significance of a vertical arrangement must be analyzed against that background.

The industry is still competitive. There are a large number of small companies (typically manufacturing a short line of either men's, women's, or children's shoes). On the other hand, a few large companies "occupy a commanding position" (R. 70). The Commission found that in 1959 the five largest shoe manufacturers turned out 24 percent of the total shoe production in the country (R. 70). Each of the three largest producers—International Shoe Company, respondent Brown, and Genesco—enjoyed a dollar volume nearly twice that of the fourth largest company and more than ten times that of the tenth largest company (R. 71).[8] Most important, as the Court found in the merger case (370 U.S. at 301),

[8] Relative standings in the industry as of 1959 were (R. 71):

	1959 rank	Pairs of shoes produced		Dollar volume
International Shoe Co.	1	31,529,543	International Shoe Co.	$283,260,000
Endicott Johnson Corp.	2	32,407,012	Brown Shoe Co.	276,549,164
Brown Shoe Co.	3	29,681,274	Genesco	276,422,000
Genesco	4	29,520,000	Endicott Johnson Corp.	148,099,113
Shoe Corp. of America	5	11,050,000	Shoe Corp. of America	117,100,000
Evy Footwear Co., Inc.	6	8,010,000	U.S. Shoe Corp.	80,858,933
Sudbury Footwear	10	6,200,000	Consolidated Nat'l Shoe Corp.	22,864,000
Kessler Shoe Co.	20	3,208,676	Five Star Shoe Co.	15,050,000
Valsey-Bristol Shoe Mfg.	30	2,517,262	Mid-States Shoe Co.	10,100,000
Evangeline Shoe Co.	40	2,224,300	Williams Shoe Mfg. Co.	7,850,000
Connors-Hoffman Footwear	50	2,035,000	Laconia Shoe Co.	5,510,000
Juvenile Shoe Corp.	60	1,650,000	M. Beckerman & Sons, Inc.	4,150,000
Liberty Shoe Co.	70	1,450,000	Sham-O-Kin Shoe Corp.	2,312,000

NOTE.—(CX 80 A-B. These figures are exclusive of slipper and rubber, canvas, or plastic footwear).

there has been a decline in the number of independent manufacturers amounting to a "definite trend" (370 U.S. at 301). Brown has been a "moving factor" in this trend toward concentration, having acquired the stock or assets of at least seven shoe-manufacturing companies in the period following World War II (370 U.S. at 302).

The trend toward concentration at the manufacturing level had been paralleled by an equally distinct trend toward forward vertical integration involving control or ownership by the larger manufacturers of increasing numbers of retail outlets. Between 1950 and 1956, nine independent shoe-store chains, operating 1,114 stores, were acquired by the large manufacturers. *United States* v. *Brown Shoe Co.*, 179 F. Supp. 721, 737 (E.D. Mo.). International Shoe Company, which had no retail outlets in 1945, had acquired 130 by 1956; Endicott-Johnson Corporation, which had 488 retail outlets in 1945, had 540 by 1956; General Shoe Company had 80 retail outlets in 1945 and 526 by 1956; and respondent Brown had no retail outlets at all in 1951 but had acquired 845 [16] outlets by 1956 (370 U.S. at 301).

Brown's recent history of vertical integration is summarized both in the district court's merger opinion (179 F. Supp. at 724–727) and in the Commission's opinion (R. 72). In 1951, Brown acquired Wohl Shoe Company, the nation's largest operator of leased shoe departments. At the time of its acquisition, Wohl operated under 250 such leases, predominantly in medium-sized cities, and mainly selling women's

[16] This figure includes those stores acquired by Brown in the Kinney merger and subsequently divested by court order.

shoes. In 1954 Brown acquired Regal Shoe Corporation, the owner and operator of a chain of 110 retail men's shoe stores throughout the country. In addition to those two major acquisitions, Brown further increased the number of its controlled retail outlets in the period from 1951–1956 by purchasing retail shoe stores in the Los Angeles area, Dallas, Midland, and Corpus Christi, Texas, and Columbus, Ohio.

But Brown's efforts toward vertical integration have not been limited to mergers. As the Court noted (370 U.S. 297, n. 1), Brown owned, operated or controlled over 1,230 retail outlets including some 570 "independently owned stores operating under the Brown 'Franchise Program' and over 190 * * * independently owned outlets operating under the 'Wohl Plan.' "[7] As the Court also noted (370 U.S. at 337–338, n. 66), "Brown was able to exercise sufficient control over these stores and departments to warrant their characterization as 'Brown' outlets for the purpose of measuring the share and effect of Brown's competition at the retail level." Significantly, while Brown was being divested of some 350 outlets which it had acquired in the Kinney merger, it increased the number of outlets under the franchise plan from 570 to some 766 (R. 62–63) at a time when the number of good retail outlets was generally declining (R. 72).

Nor was Brown alone in procuring the advantages of controlled but unowned outlets. Between 1959 and 1961, International Shoe, the largest manufacturer in

[7] The "Wohl Plan" is a franchise plan for independent stores which is similar in many respects to the Brown franchise plan, but which was not in issue in the Commission proceeding. In 1958 there were 208 "Wohl Plan" stores (R. 72).

the industry, increased by 16 percent the number of independent retailers under its Merchants Service Plan—bringing the total to 1,400 (R. 73). An additional 317 retailers were members of General Shoe's Friendly Franchise Store Plan (R. 73). These two franchise plans, while varying in terms from Brown's, were found by the Commission to have the similar effect of restricting the access of competing manufacturers to the stores involved (R. 73).[8]

The court of appeals erred in its conclusion that the economic pattern revealed in this Court's decision in *Brown Shoe Co.* v. *United States* was irrelevant and in disregarding the additional findings of the Commission. The Commission was correct in analyzing the significance of Brown's restrictive agreements with more than 700 retail outlets in the light of the twin trends toward concentration and vertical integration. It would of course be highly anomalous if, following the decision by this Court that, "in the light of the trends in this industry," it had reached "an appropriate place at which to call a halt" (370 U.S. at 346), Brown could continue to foreclose retail outlets to competing manufacturers—and to do so without the outlay of capital or risk attendant on acquisition.

Moreover, "because these trends are not the product of accident but are rather the result of deliberate

[8] Somewhat inexplicably, the court of appeals (R. 584) was of the view that the use of such franchise plans by International Shoe and General Shoe, rather than revealing the progressive foreclosure of retail outlets to smaller manufacturers, tended to show that Brown's plan could not be classified as an unfair method of competition. Compare *Standard Oil Co.* v. *United States*, 337 U.S. 293, 309, 314; *Federal Trade Commission* v. *Motion Picture Adv. Serv. Co.*, 344 U.S. 392.

policies of Brown and other leading shoe manufacturers, account must be taken of these facts in order to predict the probable future consequences * * *" (370 U.S. at 332–333). To be sure, this is not a case in which it is necessary to speculate at length as to what the future may hold. Brown's announced ~~its~~ a purpose is the "elimination of conflicting lines" (R. 54). And it was meeting with success. Stores under Brown's franchise plan purchased 75 percent of their requirements from Brown (R. 63).[9] An undetermined portion of the remaining 25 percent consisted of types of shoes which were not in competition with Brown's lines. Franchise-plan purchases from Brown amounted to more than $24,000,000 in 1959 or about $2,000,000 more than the total sales of the tenth largest shoe company in the industry (R. 71). There was substantial evidence that sales by Brown's competitors fell off precipitously when a retailer was enrolled in the franchise plan (see pp. 8–9, *supra*), and that at least some of Brown's competitors had found it "a waste of time" to attempt to sell to stores under the franchise plan (R. 73). In sum, Brown was successfully foreclosing competitors from an ever-increasing number of retail outlets.

B. THE LACK OF ECONOMIC JUSTIFICATION

It is well recognized that not all vertical arrangements are equally injurious to competition. Require-

[9] In 1957, following the Brown-Kinney merger, Brown supplied 7.9 percent of Kinney's needs and Kinney supplied 20% of its own needs. *Brown Shoe Co.* v. *United States*, 370 U.S. at 303–304.

ments contracts "may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public." *Standard Oil Co.* v. *United States,* 337 U.S. at 306. Such contracts may assure supply, give protection against price fluctuations, and make possible substantial reductions in selling expenses. *Tampa Electric Co.* v. *Nashville Coal Co.,* 365 U.S. 320, 334. On the other hand, there are circumstances under which such contracts "serve hardly any purpose beyond the suppression of competition." *Standard Oil Co.* v. *United States,* 337 U.S. at 305-306.

Whatever may be the justification for the use of exclusionary arrangements in some circumstances, it is quite apparent that there is no such redeeming feature to Brown's foreclosure of retail outlets to competing shoe manufacturers. To be sure, there are unquestionably real advantages and economies in making available to retailers the services which Brown supplies under its franchise program. But those economies could be achieved as well if Brown charged retailers for its services. The question is whether there is any redeeming value in the exaction of an exclusive dealing agreement in consideration for those services. The only explanation which Brown offered is that it is more economical and efficient for a retailer, with a limited capital available for inventory, to keep only one brand in stock to avoid stocking "overlapping patterns" of conflicting brands. While the merits and demerits of "line concentration" were

reviewed at some length (*e.g.,* R. 162-166, 177–181, 446–448), it was never made clear why the supposed advantages of line concentration could not be obtained by a retailer who purchased men's shoes from manufacturer A, women's shoes from manufacturer B, and infants' shoes from manufacturer C. Though such a system of purchasing seems fully consistent with Brown's theory of sound merchandising, it is expressly forbidden to retailers under the Brown franchise agreement.

But even if it were supposed that complete line concentration was the most efficient approach, one would expect that retailers would be eager to achieve the attendant economies and would not have to be held to the line by contractual agreement. As the Commission concluded, "While line concentration itself may or may not be economically justifiable, there is no economic justification for making the adherence to this doctrine the subject of agreement between buyer and seller and enforcing the agreement to the latter's advantage" (R. 59). Cf. *Standard Oil Co.* v. *United States,* 337 U.S. at 306.[10] Independent shoe

[10] See, also, Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act,* The Supreme Court Review (Kurland ed., 1961) 267, 307–308:

> * * * Though "loyal" dealers may seem more efficient to the seller, in the sense that they market more of his particular product, it does not follow that such dealers are more efficient from the standpoint of the public. Since dealers will generally be anxious to make as much money as they can, they are not likely to push the goods of other producers unless the public desires the other goods or unless the wholesale prices on these goods provide a higher margin of profit. As a result, to insist that dealers sell defendant's

dealers do not need restrictions on their freedom of choice in order to achieve efficiency, although they may be willing to accept such restrictions if the inducements are high enough.

Not only is the justification proffered by Brown without merit, but none of the other factors which sometimes may justify exclusive dealing contracts is relevant to Brown's franchise plan. See *Tampa Electric Co.* v. *Nashville Coal Co.*, 365 U.S. at 334–335; Bok, *op. cit., supra,* at 313 n. 117. The franchise plan does not obligate Brown with respect to price, and it is neither needed nor serves to assure the retailer of a source of supply. By no stretch of the imagination could Brown qualify as a "struggling newcomer" (see *Standard Oil Co.* v. *United States,* 337 U.S. at 308) for whom such an agreement might secure an initial foothold. The conclusion seems inescapable that, whatever may be said for exclusive dealing agreements in general, this agreement serves "hardly any purpose beyond the suppression of competition" (*id.* at 305–306) and, in this respect, "is akin to the operation of tying clauses generally held as inherently anticompetitive" (R. 68).

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product to the exclusion of others will often come close to a bare demand that more competitive goods be suppressed. Moreover, if a strong and legitimate business need for exclusive selling actually does exist, it is strange that dealers will not follow this policy without being compelled to do so by contract, for the advantages that result should benefit them as well as the firms from which they buy. Perhaps an occasional dealer will be too inept or shortsighted to perceive his best interests, but such men could presumably be replaced for demonstrable inefficiency without resorting to a widespread use of restrictive contracts.

C. THE EFFECT ON COMPETITION

The foreclosure which Brown has achieved is clearly not *de minimis* and the effect upon competition is not insubstantial. Brown's franchise program has preempted some 766 retail outlets to which Brown sold more than $24,000,000 in 1959. It is true that Brown's 766 franchised dealers constitute little more than 1 percent of the 70,000 retail shoe outlets in the country.[11] However, Brown's dealers are a "select group," all of whom were considered "the better credit risks" (R. 71). Moreover, the number of stores involved has been steadily increasing (R. 72), and since the franchise program does not require of Brown the capital outlay or risk-taking entailed in acquisitions, there is no reason to suppose that the number will not continue to increase. In *Brown Shoe,* in a passage which the Commission paraphrased in its opinion (R. 69), this Court stated that where "the foreclosure is neither of monopoly nor *de minimis* proportions, the percentage of the market foreclosed by the vertical arrangement cannot itself be decisive. In such cases, it becomes necessary to undertake an examination of various economic and historical factors in order to determine whether the arrangement under review is of the type Congress sought to proscribe" (370 U.S. at 329).

Review of those factors (see pp. 22–27, *supra*), which the court of appeals completely ignored, leads to the

[11] The Court noted in *Brown Shoe Co.* v. *United States*, 370 U.S. at 300, that less than one-third of those outlets derive 50 percent or more of their gross receipts from the sale of shoes and are classified as "shoe stores" by the Census Bureau. Brown's franchised dealers comprise approximately 3 percent of such shoe stores. As indicated above (at p. 25, *supra*) an additional 208 retailers operate under Brown's "Wohl Plan."

conclusion reached by the Commission, and by this Court before it in *Brown Shoe,* that the preemption by Brown of more than 700 retailers as its exclusive dealers tends substantially to lessen competition. Viewed in the light of the recent history of the industry, the franchise program clearly appears as the growing edge of a continuous drive toward the foreclosure of retail outlets by an increasingly concentrated group of manufacturers.

Given the inclination and the ability of Brown and a few other large manufacturers to foster the "elimination of conflicting lines" at retail, there is no reason to believe that what the Commission characterized as "a deteriorating competitive situation" (R. 74) will reverse itself. On the contrary, at least one consequence of such progressive foreclosure of retail outlets is, inevitably, to make new entries at the manufacturing level increasingly difficult as independent outlets for new manufacturers become increasingly hard to find. To the extent that new entrants are excluded, a potential source of dilution and dispersion of economic power at the manufacturing level is eliminated. Moreover, small manufacturers producing less than a full line of shoes are not in a position to exact the restrictive agreements that Brown does under its franchise plan (R. 206). By reason of size rather than superior efficiency Brown, and perhaps a few others, are able to project concentration at the manufacturing level toward the retail level thus further reducing the prospects for effective economic rivalry.

Since no redeeming economic justification has been shown for the exclusive dealing aspect of the franchise

plan, the Commission had a more than sufficient basis for condemning it. The Commission did not, however, ignore the fact, which the court of appeals thought irrelevant, that the exclusive dealing aspect of the plan is merely another means to the end proscribed by the Court in the *Brown* merger case. It is, of course, true that an exclusive dealing agreement is a less permanent arrangement than a merger. However, the Commission found that in actual operation "the relationship between Brown and its franchisees is a reasonably stable one" (R. 63). Much of the stability undoubtedly stems from the fact, noted by the Court in *Brown Shoe* (370 U.S. at 338, n. 66), that "the retailer was required, under this plan, to invest his own resources and develop his good will to a substantial extent in the sale of Brown products." Moreover, even granting the relative impermanence of a contractual arrangement, the fact remains that the franchise plan involves the preemption of approximately twice as many outlets as were involved in the Kinney merger which the court found sufficiently likely substantially to lessen competition. And, as the Commission noted (R. 70, n. 33), Kinney and Brown together supplied less than 28 percent of the Kinney stores' requirements, whereas Brown alone supplies 75 percent of the requirements of its independent franchise dealers. It seems particularly appropriate for the Commission, as an administrative agency charged with policing compliance with the antitrust laws, to seek to forestall the growth of foreclosure through exclusive dealing agreements which would effectively circumvent the Court's decision in

the merger case. The decision of the court of appeals leaves a broad path to the forbidden goal.

CONCLUSION

For the foregoing reasons the judgment of the court of appeals should be reversed.

Respectfully submitted.

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